Supreme Court, U.S.
FILED

981643 APR 12 1999

OFFICE OF THE CLERK

No. 98-

IN THE

Supreme Court of the United States

OCTOBER TERM, 1998

IN THE MATTER OF: SOUTHMARK CORPORATION,
Debtor.

SOUTHMARK CORPORATION,
Petitioner,

v.

COOPERS & LYBRAND L.L.P.,
Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

PETITION FOR A WRIT OF CERTIORARI

ROBERT B. KRAKOW
GIBSON, DUNN & CRUTCHER LLP
DALLAS, TX

OSCAR GARZA
GIBSON, DUNN & CRUTCHER LLP
ORANGE COUNTY, CA

THEODORE J. BOUTROUS, JR.
Counsel of Record
THOMAS H. DUPREE
GIBSON, DUNN & CRUTCHER LLP
1050 Connecticut Avenue, N.W.
Washington, D.C. 20036
(202) 955-8500
Counsel for Petitioner

11 pp

QUESTION PRESENTED

Whether an Article I bankruptcy court violates Article III of the Constitution when it exercises jurisdiction over and decides a state-law tort claim that arose during Chapter 11 proceedings.

PARTIES TO THE PROCEEDINGS AND RULE 29.6 STATEMENT

Petitioner is Southmark Corporation. Respondent is Coopers & Lybrand L.L.P. In addition to the parties listed in the caption, the following were parties below: Charles B. Brewer and Thompson & Knight. Southmark is not a parent or subsidiary of any publicly held corporation or any other publicly held entity.

TABLE OF CONTENTS

Page

QUESTION PRESENTED i

PARTIES TO THE PROCEEDINGS AND RULE 29.6 STATEMENT ii

TABLE OF AUTHORITIES v

OPINIONS BELOW 1

JURISDICTION 2

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED 2

STATEMENT OF THE CASE 2

REASONS FOR GRANTING THE WRIT 9

I. The Court Of Appeals' Holding That A Bankruptcy Court May Decide A State-Law Tort Claim Is Irreconcilable With This Court's Decision In *Marathon* 9

A. The Core Of The Federal Bankruptcy Power Does Not Encompass State-Law Tort Suits 11

B. A Bankruptcy Court's Purported Duty To "Police The Fiduciaries" Cannot Justify Evading The Limits of *Marathon* 17

C. The Bankruptcy Statute Cannot Be Interpreted To Grant Bankruptcy Courts Jurisdiction Prohibited By *Marathon* 19

II. Review Is Necessary To Resolve Conflicts Among The Courts Of Appeals And To Dispel The Lower Courts' Confusion Over The Scope Of Core Jurisdiction..... 22

CONCLUSION 25

TABLE OF AUTHORITIES

CASES Page(s)

Bowsher v. Synar, 478 U.S. 714 (1986).....18

Celotex Corp. v. Edwards, 514 U.S. 300 (1995).....15

Commodity Futures Trading Comm'n v. Schor, 478 U.S. 833 (1986).....14

Granfinanciera, S.A. v. Nordberg, 492 U.S. 33 (1989).....*passim*

Gower v. Farmers Home Admin. (In re Davis), 899 F.2d 1136 (11th Cir. 1990).....23

Halper v. Halper, 164 F.3d 830 (3d Cir. 1999).....22

Healy v. Ratta, 292 U.S. 263 (1934).....16

Helmer v. Murray (In re Murray), 149 B.R. 383 (E.D. Va. 1993).....21

Moody v. Amoco Oil Co., 734 F.2d 1200 (7th Cir. 1984).....23

Northern Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982).....*passim*

Orion Pictures Corp. v. Showtime Networks, Inc. (In re Orion Pictures Corp.), 4 F.3d 1095 (2d Cir. 1993).....23

Pettibone Corp. v. Easley, 935 F.2d 120 (7th Cir. 1991).....16

Piombo Corp. v. Castlerock Props. (In re Castlerock Props.), 781 F.2d 159 (9th Cir. 1986).....20-21

In re Robert D. Johnson, 960 F.2d 396 (4th Cir. 1992).....21

Satelco, Inc. v. North Am. Publishers, Inc. (In re Satelco, Inc.), 58 B.R. 781 (Bankr. N.D. Tex. 1986) 21

In re Sauer, 191 B.R. 402 (Bankr. D. Neb. 1995) 16

Schoenthal v. Irving Trust Co., 287 U.S. 92 (1932) 13-14

Taxel v. Electronic Sports Research (In re Cinematronics, Inc.), 916 F.2d 1444 (9th Cir. 1990) 22

Thomas v. Union Carbide Agric. Prods. Co., 473 U.S. 568 (1985) 10, 15

Torkelson v. Maggio (In re Guild and Gallery Plus, Inc.), 72 F.3d 1171 (3d Cir. 1996) 22,23

In re United States Brass Corp., 110 F.3d 1261 (7th Cir. 1997) 12

United States v. Yochum (In re Yochum), 89 F.3d 661 (9th Cir. 1996) 23

CONSTITUTION AND STATUTES

U.S. CONST. art. III, § 1 ..... *passim*

11 U.S.C. § 105(a) 18

11 U.S.C. § 327 18

11 U.S.C. § 327(a) 16

11 U.S.C. § 328 18

11 U.S.C. § 365 23

28 U.S.C. § 157 2

28 U.S.C. § 157(b)(1) 11

28 U.S.C. § 157(b)(2) 11,21

28 U.S.C. § 157(b)(2)(A) 19

28 U.S.C. § 157(b)(2)(B) 19

28 U.S.C. § 157(b)(2)(H) 20
28 U.S.C. § 157(b)(2)(O) 19
28 U.S.C. § 157(b)(3) 12
28 U.S.C. § 1254(1) 2
28 U.S.C. § 1334(c)(1) 17
28 U.S.C. § 1334(c)(2) 2,7,11

MISCELLANEOUS

Susan Block-Lieb, *The Costs of a Non-Article III Bankruptcy Court System*, 72 AM. BANKR. L.J. 529 (1998) 23

13 Charles Alan Wright et al., FEDERAL PRACTICE AND PROCEDURE § 3522 (2d ed. 1984) 16

IN THE
Supreme Court of the United States
OCTOBER TERM, 1998

NO. 98-

IN THE MATTER OF: SOUTHMARK CORPORATION,
Debtor.

SOUTHMARK CORPORATION,
Petitioner,

v.

COOPERS & LYBRAND L.L.P.,
Respondent.

On Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

PETITION FOR A WRIT OF CERTIORARI

Petitioner Southmark Corporation ("Southmark") respectfully submits this petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a) is reported at 163 F.3d 925. The ruling of the district court, rendered orally from the bench, is reproduced at App., *infra,* 27a. The opinion of the bankruptcy court is reproduced at App., *infra*, 33a.

JURISDICTION

The judgment of the court of appeals was entered on January 11, 1999. App., *infra*, 1a. This petition is timely filed pursuant to Supreme Court Rules 13 and 30. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Article III, Section 1 of the United States Constitution and the pertinent provisions of the United States Code, 28 U.S.C. §§ 157 & 1334(c)(2), are reproduced at App., *infra*, 73a-77a.

STATEMENT OF THE CASE

This case presents the question whether a bankruptcy court may decide a state-law malpractice claim without violating the constitutional limits this Court recognized in *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982). The jurisdiction of an Article I bankruptcy court is quite narrow: absent consent of the litigants, it may only decide controversies that arise under Title 11 or that lie "at the core of the federal bankruptcy power." *Id.* at 71. If a controversy is unconnected with, or merely "related to" bankruptcy, the court may not decide it. The United States Court of Appeals for the Fifth Circuit held that Southmark's ordinary state-law malpractice claim fell within the bankruptcy court's core jurisdiction on the basis of its tenuous connection to a Chapter 11 reorganization that had concluded nearly five years before.

The court of appeals' expansive interpretation of the core of bankruptcy demolishes the delicate jurisdictional structure this Court established in

Marathon. Under the Fifth Circuit's reasoning, a litigant in an ordinary state-law tort suit forfeits his constitutional right to an Article III decisionmaker merely because the tort was committed during a bankruptcy proceeding. Review of this decision is necessary to demark the constitutional limits on the decisionmaking powers of Article I bankruptcy courts.

1. Southmark's state-law claims arose as a result of Coopers & Lybrand's ("Coopers") tortious conduct while performing accounting services in connection with Southmark's Chapter 11 reorganization. Southmark is a real estate investment trust that sponsored private and publicly syndicated real estate partnerships throughout the 1980's. App., *infra*, 2a. From 1982 until shortly before Southmark filed for bankruptcy in 1989, Drexel Burnham Lambert, Inc. ("Drexel") served as Southmark's primary investment banker, underwriter, securities broker, and investment and financial advisor. Drexel served as the underwriter for over $1 billion of junk bonds and preferred stock offered by Southmark. *Id.* In its role as financial advisor, Drexel pressured Southmark to issue these securities, the proceeds of which would be used to purchase junk bonds of other Drexel clients. As a result of Drexel's scheme, in October 1986 Southmark issued $400 million in junk bonds and $100 million in preferred stock. *Id.* at 3a. All of the junk bond proceeds and part of the stock revenues were promptly used to buy other junk bond securities. *Id.*

In April 1989, Southmark announced a $1 billion write-down of its asset values, wiping out shareholders' equity. *Id.* In July 1989, Southmark filed for bankruptcy under Chapter 11. Shortly

thereafter, Southmark requested the appointment of an Examiner to provide "an unbiased, independent assessment of the propriety and practicality of pursuing litigation against third-parties." *Id.* The Examiner applied to the bankruptcy court to retain Coopers as accountant to the Examiner. Although Coopers noted that it performed some accounting work for Drexel, it failed to disclose that it was Drexel's outside auditor. *Id.* Nor did Coopers reveal that Drexel paid Coopers "approximately $6.7 million for 1987 services, $6.9 million for 1988 services and $4.9 million for 1989 services." *Id.* at 45a.

Coopers assigned responsibility for investigating Southmark's possible claims against Drexel to a manager, William Galbally. *Id.* at 47a. After a preliminary month-long investigation, Galbally concluded that Southmark could assert substantial legal claims against Drexel and that further investigation was warranted. *Id.* In a meeting with David Carpenter, the head of the Coopers engagement team for the Southmark project, Galbally reported his conclusions and declared that the claims against Drexel would be the biggest issue in the engagement. Record ("R."), Vol. III at 259. Carpenter was infuriated by Galbally's report and yelled, "Don't fuck with Drexel. Drexel is our largest audit client." *Id.*; R., Vol. VII, tab 1 at 28-29. The meeting ended with Carpenter removing Galbally from the Drexel investigation. App., *infra*, 48a.

In March 1990, Coopers orally presented to the Examiner its findings on various issues, including the Drexel investigation. R., Vol. II at 64. This presentation was shortly followed by a written report focusing on Drexel; this report, delivered to

the Examiner, contained Coopers' final conclusions concerning Southmark's potential claims against Drexel. *Id.*; R., Vol. VII, tab 3 at 72. The report was plainly based on a half-hearted and incomplete investigation of Drexel's misconduct. It concluded that "the buyers of Southmark securities may be able to put forth a class action type claim against Drexel for lack of due diligence or the like but a claim on behalf of the estate is not readily apparent." R., Vol. VII, tab 2 at 81. The Examiner's report integrated these conclusions and advised that although Southmark's potential claims had been "extensively" investigated, they would be difficult to prove. R., Vol. III at 266, 271.

Southmark emerged from bankruptcy in August 1990, and immediately began to pursue various claims identified by the Examiner. Drexel's parent company had declared bankruptcy earlier in the year and the court had set a November bar date for filing claims against the estate. App., *infra*, 45a. Because the Examiner's report had failed to identify any substantial claims Southmark might assert against Drexel, Southmark declined to authorize any further investigation. R., Vol. 7, tab 5 at 8-14. In the end, Southmark filed no claim in the Drexel bankruptcy. App., *infra*, 4a. Instead, in early 1991, Southmark engaged outside counsel to investigate Drexel-related claims with an eye toward pursuing claims against Michael Milken—an investigation that paralleled the inquiry Galbally had intended to conduct before his sudden removal. R., Vol. VII, tab 5 at 16-17 & tab 1 at 36-37. Ultimately, Southmark reached a settlement agreement that yielded more than $30 million from the Milken settlement fund.

2. Galbally, still employed by Coopers, stepped forward in April 1993—over two-and-a-half years after Southmark emerged from bankruptcy—and disclosed to Southmark's general counsel the circumstances surrounding his aborted investigation and removal from the case. App., *infra*, 4a. Southmark promptly launched an investigation into Coopers' conduct and filed a motion for disgorgement in the bankruptcy court, seeking reconsideration of the award of fees to Coopers during its Southmark engagement. *Id.* The motion was premised on Coopers' failure to satisfy the bankruptcy court's disclosure and disinterestedness requirements. R., Vol. II at 13-18. Southmark sought only a disgorgement of fees; it did not seek recovery for the damages it suffered as a result of Coopers' deception. The bankruptcy court granted the motion and awarded Southmark roughly $585,000, which included a portion of the fee paid to Coopers for the engagement in addition to Southmark's attorneys' fees. App., *infra*, 4a, 56a. The court found that "Coopers' failure to fully disclose connections and activities with and regarding Drexel prevented the court from fully performing its function under the Bankruptcy Code and thereby frustrated the purposes of the Code to assure that the professional person employed by the examiner tenders undivided loyalty and provides untainted advice and assistance." *Id.* at 52a.

3. In April 1995, nearly *five years* after emerging from bankruptcy, Southmark sued Coopers in the 134th Judicial District Court, Dallas County, Texas, seeking money damages under Texas law for breach of contract, fraud and deceit, breach of fiduciary duty, and negligent misrepresentation. *Id.* at 67a-71a. The complaint alleged that Coopers' failure to conduct a reasonably

thorough investigation deterred Southmark from pursuing potential claims against Drexel or filing a proof of claim in the Drexel bankruptcy. *Id.* at 66a. Coopers removed the action to the United States Bankruptcy Court for the Northern District of Texas, which had presided over Southmark's Chapter 11 case. Southmark then filed a motion for mandatory abstention or, in the alternative, discretionary abstention or remand, on the grounds that its state-law malpractice claim was a non-core proceeding required to be returned to state court under 28 U.S.C. § 1334(c)(2). *Id.* at 5a. Coopers responded by filing a motion for judgment on the pleadings, contending that the prior disgorgement proceeding collaterally estopped Southmark from claiming that Coopers' misconduct caused Southmark to suffer damages.

The bankruptcy court granted Coopers' motion for judgment on the basis of both issue and claim preclusion, and denied as moot Southmark's motion for abstention. *Id.* at 41a-42a. The United States District Court for the Northern District of Texas affirmed, finding that Southmark's malpractice claim fell within the bankruptcy court's core jurisdiction. *Id.* at 30a. Although the bankruptcy court had failed to make any sort of jurisdictional finding, the district court determined that such a finding was implicit in the ruling. *Id.* at 30a-31a.

The United States Court of Appeals for the Fifth Circuit affirmed the district court, holding that "the state-law malpractice claim is a 'core proceeding' in bankruptcy" and that the prior disgorgement proceeding gave rise to issue preclusion. *Id.* at 2a. The court reasoned that although Southmark's cause of action arose under state law, it nonetheless fell within the bankruptcy court's core jurisdiction

because it was "inseparable from the bankruptcy context." *Id.* at 12a. The court noted that two of Southmark's allegations—its breach of fiduciary duty and breach of contract claims—implicated contractual terms that were approved by the bankruptcy court. *Id.*

Acknowledging the *Marathon* Court's holding that the core of the federal bankruptcy power is "the restructuring of debtor-creditor relations," 458 U.S. at 71, the court of appeals explained that "[a] *sine qua non* in restructuring the debtor-creditor relationship is the court's ability to police the fiduciaries . . . responsible for managing the debtor's estate." App., *infra*, 12a. Moreover, "[a]ward of the professionals' fees and enforcement of the appropriate standards of conduct are inseparably related functions of bankruptcy courts." *Id.* at 13a. Finally, the court characterized Southmark's claim as "one to recover an asset of Southmark's estate that Coopers let slip away," and therefore an appropriate dispute for the bankruptcy court to decide. *Id.* at 14a.

Having satisfied itself that the bankruptcy court properly exercised jurisdiction, the court of appeals next concluded that Southmark was collaterally estopped from claiming that Coopers' misconduct caused it to suffer damages. The court reasoned that the issue was actually litigated and resolved in the disgorgement proceeding. *Id.* at 16a-20a. Although the court criticized the lower courts' "rather perfunctory reliance on claim preclusion" and cast doubt on their conclusions, it nonetheless affirmed the lower courts' dismissal of Southmark's case on the basis of issue preclusion. *Id.* at 20a.

REASONS FOR GRANTING THE WRIT

Seventeen years ago, in *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982), this Court struck down Congress' attempt to expand beyond constitutional bounds the jurisdiction of Article I bankruptcy courts. The Court held that a bankruptcy court can decide only those controversies that fall within "the core of the federal bankruptcy power"—a narrow zone limited to matters involving "the restructuring of debtor-creditor relations . . . [as] distinguished from the adjudication of state-created private rights." *Id.* at 71. Lower courts have since struggled to define precisely what types of claims are included within "core" jurisdiction, their task complicated by the ambiguous bankruptcy statute enacted in *Marathon*'s wake.

The result of this confusion is well illustrated by the Fifth Circuit's decision below. Confronted with a claim requiring "the adjudication of state-created private rights," the court relied on broad statutory language and policy goals to implement its expansive vision of the role of bankruptcy courts—a vision directly at odds with the jurisdictional limits imposed by Article III and upheld by this Court in *Marathon*. Review is warranted to resolve this substantial and important issue of constitutional law and to clarify the permissible scope of bankruptcy courts' jurisdiction.

I. The Court Of Appeals' Holding That A Bankruptcy Court May Decide A State-Law Tort Claim Is Irreconcilable With This Court's Decision In *Marathon*

In *Marathon*, this Court held that Congress could not vest Article I bankruptcy courts with the

authority to adjudicate state-created private rights. In the 1978 Bankruptcy Code, Congress had delegated to untenured bankruptcy judges all jurisdiction conveyed to the Article III district courts. The Court struck down this provision on separation-of-powers grounds, warning that such a sweeping jurisdictional grant "threatens to supplant completely our system of adjudication in independent Art. III tribunals and replace it with a system of 'specialized' legislative courts." 458 U.S. at 73.

Bankruptcy courts were not left powerless, however. The Court explained that bankruptcy courts could, consistent with Article III, adjudicate matters involving "the restructuring of debtor-creditor relations" that fall within "the core of the federal bankruptcy power." *Id.* at 71. But the Constitution forbids their "adjudication of state-created private rights, such as the right to recover contract damages that is at issue in this case." *Id.*[1] Congress incorporated *Marathon*'s core/non-core distinction in passing the Bankruptcy Amendments and Federal Judgeship Act of 1984, which permits

---

[1] Courts, including the court of appeals below, App., *infra*, 9a, have often looked to Chief Justice Burger's opinion as the narrowest interpretation of the plurality's holding. *See Marathon*, 458 U.S. at 92 (Burger, C.J., dissenting) ("[T]he Court's holding is limited to the proposition . . . that a 'traditional' state common-law action, not made subject to a federal rule of decision, and related only peripherally to an adjudication of bankruptcy under federal law, must, absent the consent of the litigants, be heard by an 'Art. III court.'"). *See also Thomas v. Union Carbide Agric. Prods. Co.*, 473 U.S. 568, 584 (1985) (citing Burger, C.J., dissenting opinion).

bankruptcy judges to "hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11." 28 U.S.C. § 157(b)(1). The statute provides a non-exclusive list of specific matters and claims that fall within core jurisdiction. *See* 28 U.S.C. § 157(b)(2).

In the decision below, the Fifth Circuit agreed with the bankruptcy judge that Southmark's claims fell within the bankruptcy court's core jurisdiction and accordingly upheld its decision not to abstain.[2] In reaching this result, the court relied on the reconfigured jurisdictional statute, coupled with a breathtaking mischaracterization of the nature of Southmark's claim, to achieve indirectly what *Marathon* prevents Congress from doing directly—empower bankruptcy courts to adjudicate state-law controversies that have no bearing on the restructuring of debtor-creditor relations.

A. The Core Of The Federal Bankruptcy Power Does Not Encompass State-Law Tort Suits

The Fifth Circuit's conclusion that Southmark's state-law tort claims fall within a bankruptcy court's core jurisdiction is flatly contradicted by *Marathon* and, if followed by other courts, will erode the constitutional limits on Article I courts. As the court of appeals acknowledged, App., *infra*, 11a-12a, Southmark's claims arose under Texas law; its right to sue Coopers for breach of contract, fraud, breach

---

[2] A bankruptcy judge is required to abstain under 28 U.S.C. § 1334(c)(2) in non-core state-law claims that lack any other basis for federal jurisdiction and that can be timely adjudicated in a state forum of appropriate jurisdiction.

of fiduciary duty and negligent misrepresentation were conferred not by the federal bankruptcy code but by the State of Texas.[3] Moreover, as the court of appeals explained, Texas law also provided the standard by which Coopers' liability would be judged. *Id.* at 13a (noting that "standards for the conduct of court-appointed professionals, the breach of which may constitute bankruptcy malpractice, are not comprehensively expressed in the [Bankruptcy Code]"). Accordingly, the substantive nature of Southmark's claims fall squarely within the category of "state-created private rights" that must be adjudicated by an Article III court. *Marathon*, 458 U.S. at 71. As Judge Posner has recognized, core jurisdiction must be confined to causes of action conferred by the Bankruptcy Code. *See In re United States Brass Corp.*, 110 F.3d 1261, 1268 (7th Cir. 1997) ("Core proceedings are actions by or against the debtor that arise under the Bankruptcy Code in the strong sense that the Code itself is the source of the claimant's right or remedy, rather than just the procedural vehicle for the assertion of a right conferred by some other body of law, normally state law.").

The court below sought to escape this obvious conclusion by insisting that because the tort claims

---

[3] Section 157(b)(3) provides that "[a] determination that a proceeding is not a core proceeding shall not be made solely on the basis that its resolution may be affected by State law." 28 U.S.C. § 157(b)(3). This statutory provision, of course, cannot be interpreted to expand the core jurisdiction of Article I judges beyond the constitutional boundaries established in *Marathon*. In any event, the Subsection merely provides that a claim arising under state law is not *automatically* deemed non-core.

arose in a "bankruptcy setting," App., *infra*, 12a, they fell within the core of the federal bankruptcy power. This rationale is plainly insufficient under *Marathon*, which limited bankruptcy courts' jurisdiction to a narrow subset of cases arising *within* the bankruptcy setting. Indeed, the very facts of *Marathon* illustrate this point: a Chapter 11 debtor brought a state-law action for breach of contract and warranty, misrepresentation and duress, yet the Court held that the mere fact these claims arose in a bankruptcy setting was insufficient to trigger core jurisdiction. The heart of the inquiry, the Court explained, is the substantive nature, public or private, of the asserted right. If the right is a private right—one which involves "the liability of one individual to another"—it must be decided by an Article III court. *Id.* at 69-70 (citation omitted). As this Court stated in *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 56 (1989), *Marathon* "emphasized that state-law causes of action for breach of contract or warranty are paradigmatic private rights, even when asserted by an insolvent corporation in the midst of Chapter 11 reorganization proceedings," and therefore inappropriate for resolution by anything other than an Article III court.

The post-*Marathon* jurisprudence of this Court confirms that untenured bankruptcy judges are constitutionally forbidden from adjudicating the types of claims at issue here. In *Granfinanciera*, the Court held that a defendant sued by the bankruptcy trustee for a fraudulent conveyance was entitled to a jury trial because such claims "constitute no part of the proceedings in bankruptcy but concern controversies arising out of it" and therefore were matters of private right. 492 U.S. at 56 (quoting *Schoenthal v. Irving Trust Co.*, 287 U.S. 92, 94-95

(1932)).[4] The Court reasoned that fraudulent conveyance claims "more nearly resemble state-law contract claims brought by a bankrupt corporation to augment the bankruptcy estate than they do creditors' hierarchically ordered claims to a pro rata share of the bankruptcy res." *Id.* It concluded that because the action was not "integral to the restructuring of debtor-creditor relations[,] Congress therefore cannot divest petitioners of their Seventh Amendment right to a trial by jury." *Id.* at 58-59. Southmark's claim here is no different from the claim in *Granfinanciera*: It is a private tort claim that is not "integral to the restructuring of debtor-creditor relations" and should not have been adjudicated by an Article I judge.[5]

---

[4] The Court prefaced its discussion by explaining that its analysis whether the defendant was entitled to a jury trial was identical to the analysis whether Congress could empower a bankruptcy judge to adjudicate the matter. *See Granfinanciera*, 492 U.S. at 53 (citation omitted): "Indeed, our decisions point to the conclusion that, if a statutory cause of action is legal in nature, the question whether the Seventh Amendment permits Congress to assign its adjudication to a tribunal that does not employ juries as factfinders requires the same answer as the question whether Article III allows Congress to assign adjudication of that cause of action to a non-Article III tribunal. For if a statutory cause of action . . . is not a 'public right' for Article III purposes, then Congress may not assign its adjudication to a specialized non-Article III court lacking the essential attributes of the judicial power."

[5] Other decisions by this Court have reaffirmed *Marathon*'s central holding. In *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833, 850 (1986), the Court explained that "Article III, § 1, safeguards the role of the Judicial Branch in our tripartite system by barring congressional attempts to transfer

In fact, in *Granfinanciera*, this Court went a step further, casting doubt on the legitimacy of virtually *any* final adjudication by bankruptcy judges. The Court cautioned, "[w]e do not suggest that the restructuring of debtor-creditor relations is in fact a public right." 492 U.S. at 56 n.11. If the restructuring of debtor-creditor relations falls outside the sphere of matters that may be adjudicated by Article I judges, it is inconceivable that a tort claim arising between two private parties is included within a bankruptcy court's core jurisdiction.

Furthermore, the undisputed fact that Southmark filed its state-law action nearly five years after emerging from bankruptcy illustrates how far removed this case is from the core of the federal

---

jurisdiction to non-Article III tribunals for the purpose of emasculating constitutional courts, and thereby preventing the encroachment or aggrandizement of one branch at the expense of the other" (citations and brackets omitted). The Court underscored its duty to scrutinize congressional attempts to control the adjudication of "rights [that] were historically . . . subject to resolution by Article III courts." *Id.* at 854. *See also Thomas*, 473 U.S. at 584 (*Marathon* establishes that "Congress may not vest in a non-Article III court the power to adjudicate, render final judgment, and issue binding orders in a traditional contract action arising under state law, without consent of the litigants, and subject only to ordinary appellate review."); *Celotex Corp. v. Edwards*, 514 U.S. 300, 316, 323 (1995) (Stevens, J., dissenting) (noting that "the jurisdiction and the power of bankruptcy judges are cabined by specific and important . . . constitutional constraints" and questioning Bankruptcy Code's delegation of jurisdiction to Article I judges).

bankruptcy power. Southmark's claims were adjudicated not in the context of an ongoing bankruptcy proceeding, but long after the proceeding had ended. This immense time lapse further undercuts the court of appeals' conclusion that Southmark's 1995 action involves the restructuring of debtor-creditor relations—a restructuring that had ended by 1990.[6]

In addition to encroaching on the separation of powers, the ruling below also threatens fundamental principles of federalism. Southmark's state-law claim was adjudicated by a federal bankruptcy court that lacked any basis for federal jurisdiction save for a tangential and tenuous connection to a long-concluded bankruptcy proceeding. Southmark's claim did not raise a federal question, nor did either party even allege the existence of diversity jurisdiction. This Court has historically upheld "[t]he power reserved to the states, under the Constitution, to provide for the determination of controversies in their courts." *Healy v. Ratta*, 292 U.S. 263, 270 (1934). *See also* 13 Charles Alan Wright et al., FEDERAL PRACTICE AND PROCEDURE § 3522, at 61-62 (2d ed. 1984) ("[I]t would not simply be wrong but indeed would be an unconstitutional invasion of the powers reserved to

---

[6] Because Coopers' duty to disclose its conflict of interest was ongoing, *see* App, *infra*, 47a, 11 U.S.C. § 327(a), *In re Sauer*, 191 B.R. 402, 407 (Bankr. D. Neb. 1995), its tortious conduct also encompassed the four-month post-confirmation period from July to November 1990. *See Pettibone Corp. v. Easley*, 935 F.2d 120, 122 (7th Cir. 1991) ("Once the bankruptcy court confirms a plan of reorganization, the debtor may go about its business without further supervision or approval.").

the states if the federal courts were to entertain cases not within their jurisdiction."). By ruling on issues of Texas law with no independent basis for federal jurisdiction, the federal bankruptcy court wrongly usurped the prerogative of the Texas state courts and denied Southmark its right to have its state-law claims adjudicated in state court.

The vehicle for this unjustified intrusion on the state courts was 28 U.S.C. § 1334(c)(1), which empowers federal bankruptcy courts to determine even pure questions of state law that are deemed to fall within core jurisdiction. In this way, the court of appeals' expansive vision of core jurisdiction endangers not only the separation of powers, but directly threatens long-recognized principles of federalism. Permitting important questions of state law to be determined by a non-tenured federal bankruptcy judge—particularly, as here, in the absence of *any* connection to an ongoing bankruptcy proceeding—amounts to a dangerous and needless expansion of federal jurisdiction.

B. A Bankruptcy Court's Purported Duty To "Police The Fiduciaries" Cannot Justify Evading The Limits of *Marathon*

The court of appeals reasoned that Southmark's claims fell within core jurisdiction because they implicated "the court's ability to police the fiduciaries . . . who are responsible for managing the debtor's estate in the best interest of creditors." App., *infra,* 12a. This novel argument rests upon a profound mischaracterization of Southmark's claim. Southmark sued Coopers in tort to vindicate a *private* right conferred under Texas law. Any *public* interest in ensuring that Coopers' conduct

conformed to law was satisfied by the disgorgement proceeding. The bankruptcy court expressly recognized this point. In ordering Coopers to disgorge $585,000 in fees and other expenses, it determined that "Coopers' failure to fully disclose connections and activities with and regarding Drexel prevented the court from fully performing its function under the Bankruptcy Code and thereby frustrated the purposes of the Code to assure that the professional person employed by the examiner tenders undivided loyalty and provides untainted advice and assistance." *Id.* at 52a.

A bankruptcy court's ability to police court-appointed professionals is not hampered in the least by denying it jurisdiction over malpractice claims. The Bankruptcy Code grants bankruptcy judges a variety of means of policing its appointees, including sanctions under 11 U.S.C. § 105(a), disqualification under 11 U.S.C. § 327, and—as illustrated here—disgorgement under 11 U.S.C. § 328. Stretching the bounds of Article III to protect a public interest already secured in so many other ways is therefore wholly unjustified. Even if private tort suits are somehow deemed to serve a marginal public "policing" purpose, "the fact that a given law or procedure is efficient, convenient, and useful in facilitating functions of government, standing alone, will not save it if it is contrary to the Constitution." *Bowsher v. Synar*, 478 U.S. 714, 736 (1986) (citation omitted). In any event, by anointing the "policing" function a "*sine qua non* in restructuring the debtor-creditor relationship," App., *infra*, 12a, the Fifth Circuit empowers bankruptcy courts to decide any matter even remotely involving court-appointed professionals on the basis of a policy goal already realized in the Bankruptcy Code itself.

The court of appeals also suggested that core jurisdiction existed because "[s]upervising the court-appointed professionals . . . bears directly on the distribution of the debtor's estate" and that "[i]f the estate is not marshaled and liquidated or reorganized expeditiously, there will be far less money available to pay creditors' claims." *Id.* at 13a. But the fact that Coopers' honest and expeditious performance of its duties would have financially benefited Southmark's estate is immaterial under *Marathon*. *See* 458 U.S. at 71-72 ("Appellant Northern's right to recover contract damages *to augment its estate* is one of private right" and therefore falls outside core jurisdiction.) (citation omitted and emphasis added). Permitting bankruptcy courts to decide claims involving any conduct that may have a financial effect on an estate would result in an exponential expansion of core jurisdiction.

C. The Bankruptcy Statute Cannot Be Interpreted To Grant Bankruptcy Courts Jurisdiction Prohibited By *Marathon*

While it is impossible to determine the precise statutory basis, if any, supporting the court of appeals' finding of core jurisdiction, the court noted two provisions in particular: 28 U.S.C. §157(b)(2)(A) ("matters concerning the administration of the estate") and § 157(b)(2)(O) ("other proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor-creditor . . . relationship"). App., *infra*, 10a.[7] Even if Southmark's claims

---

[7] The court also mentioned in passing § 157(b)(2)(B), although it mistakenly cited the provision as § 157(2)(B). App., *infra*, 14a. In any event, the section

arguably fall within either of these provisions, the statute cannot be construed to grant Article I courts jurisdiction denied them under the Constitution.

In *Granfinanciera,* 492 U.S. 33, this Court held that a defendant sued by the bankruptcy trustee for a fraudulent conveyance was entitled to a jury trial, even though Congress—in the same section at issue here—had classified suits involving fraudulent conveyances as core proceedings that could be adjudicated by bankruptcy judges. *See* 28 U.S.C. § 157(b)(2)(H). The Court explained that Congress impermissibly "reclassified a preexisting, common-law cause of action that was not integrally related to the reformation of debtor-creditor relations." 492 U.S. at 60. "This purely taxonomic change," the Court concluded, "cannot alter our Seventh Amendment analysis." *Id* at 61. Here, just as in *Granfinanciera*, the jurisdictional provisions of the Bankruptcy Code cannot be construed to dilute a constitutional mandate.

In fact, courts across the country have recognized that a straightforward interpretation of subsections (A) and (O) would violate this Court's holding in *Marathon* because the provisions would enable bankruptcy courts to decide the very type of disputes, such as breach-of-contract claims, considered in *Marathon* itself. These courts have therefore ignored or constricted these two sections when considering a challenge to core jurisdiction. *See, e.g., Piombo Corp. v. Castlerock Props. (In re*

---

is inapplicable here, in that it extends core jurisdiction to "allowance or disallowance of claims against the estate."

Castlerock Props.), 781 F.2d 159, 162 (9th Cir. 1986) (holding that state-law contract claims are non-core proceedings even if they fit within subsections (A) or (O) because "[t]o hold otherwise would allow the bankruptcy court to enter final judgments that this court has held unconstitutional"); *Helmer v. Murray (In re Murray)*, 149 B.R. 383, 386 (E.D. Va. 1993) ("Although Section 157(b)(2) was meant by Congress to be a non-exclusive list of what might be included in the term 'core' proceedings, this court does not believe the sections or categories should be interpreted or expanded so as to in effect emasculate the jurisdictional proscriptions of the *Marathon* case.") (citation omitted); *Satelco, Inc. v. North Am. Publishers, Inc. (In re Satelco, Inc.)*, 58 B.R. 781, 788 (Bankr. N.D. Tex. 1986) ("The courts are . . . placed squarely between the constitutionally permissible jurisdictional parameters for Article I courts prescribed by the Supreme Court, and the apparent liberality of the subsequent Congressional enactment."). *See also In re Robert D. Johnson*, 960 F.2d 396, 401 (4th Cir. 1992) ("[W]e find it unnecessary to resort to this broad language [of subsections (A) and (O)] and thus risk exceeding the constitutional limitations of *Marathon*.").

The Fifth Circuit's interpretation of Section 157 amounts to a resurrection and reinstatement of the unconstitutionally broad jurisdictional provisions of the 1978 Code, which permitted bankruptcy courts to decide all matters relating to a bankruptcy proceeding. By empowering a bankruptcy judge to decide matters committed under the Constitution to an Article III tribunal, the decision below endangers the separation of powers and compels review by this Court.

II. Review Is Necessary To Resolve Conflicts Among The Courts Of Appeals And To Dispel The Lower Courts' Confusion Over The Scope Of Core Jurisdiction

Review of the decision below is further warranted to clarify the scope of core jurisdiction in light of *Marathon* and the bankruptcy statute enacted in *Marathon*'s wake. Confusion over what claims fall within the core of the federal bankruptcy power has split the circuits on a series of important and recurring issues. As the Third Circuit aptly recognized, "Bankruptcy Court jurisdiction has been the subject of heated controversy in recent decades." *Halper v. Halper*, 164 F.3d 830, 835 (3d Cir. 1999).

Foremost among these splits is the question squarely presented by this case: whether a state-law claim against a court-appointed professional constitutes a core proceeding. The decision of the court below stands in stark conflict with the Ninth Circuit's decision in *Taxel v. Electronic Sports Research (In re Cinematronics, Inc.)*, 916 F.2d 1444 (9th Cir. 1990), and the Third Circuit's decision in *Torkelson v. Maggio (In re Guild and Gallery Plus, Inc.)*, 72 F.3d 1171 (3d Cir. 1996).

In *Cinematronics*, the Chapter 11 trustee and the debtor's president (who served with court approval) were sued under a variety of state-law theories, including breach of contract, breach of fiduciary duty and fraud for conduct that occurred post-petition. 916 F.2d at 1447. The court held that the proceeding was non-core, rejecting the view that "claims arising from conduct connected with the estate after the Chapter 11 petition is filed concern the administration of the estate and qualify as core matters." *Id.* at 1450. The court reasoned that "[a] judgment against [the defendant] would not directly

determine or adjust the relationship of the . . . estate to its creditors," nor would the claims "directly affect the estate or the confirmation of the estate's plan." *Id.* In *Guild and Gallery*, the Third Circuit reached the same conclusion. There, the court held that negligence and conversion claims against a Chapter 7 trustee were non-core, noting that the plaintiff's "state law claims are not comparable to the filing of a proof of claim or raising an objection to a discharge of a particular debt." 72 F.3d at 1178. The court further noted that the plaintiff's claims "certainly could exist outside of bankruptcy [and] could all be filed in a state court." *Id.* Moreover, the claims did not "invoke[ ] a substantive right provided by title 11." *Id.* (citation omitted).

Many other conflicts flow from the uncertainty generated by *Marathon*. For example, courts have disagreed over whether an action to recover attorneys' fees under various federal fee-shifting statutes is core, *compare, e.g., Gower v. Farmers Home Admin. (In re Davis)*, 899 F.2d 1136, 1138-39 (11th Cir. 1990), *with, e.g., United States v. Yochum (In re Yochum)*, 89 F.3d 661, 670 (9th Cir. 1996); and whether proceedings to assume or reject an executory contract or an unexpired lease under 11 U.S.C. § 365 are core, *compare, e.g., Moody v. Amoco Oil Co.*, 734 F.2d 1200, 1208 (7th Cir. 1984), *with, e.g., Orion Pictures Corp. v. Showtime Networks, Inc. (In re Orion Pictures Corp.)*, 4 F.3d 1095, 1102 (2d Cir. 1993). *See generally* Susan Block-Lieb, *The Costs of a Non-Article III Bankruptcy Court System*, 72 AM. BANKR. L.J. 529, 550 (1998) (noting abundance of circuit splits concerning definition of "core proceeding").

As the foregoing discussion makes clear, the circuits are in a terrible state of confusion over how

to determine whether a claim falls within the core of bankruptcy jurisdiction. The conflicts will only worsen as new causes of action are reviewed and classified by courts uncertain over Article III's scope. This Court should grant review to resolve this important question and clarify the bounds of core jurisdiction.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

ROBERT B. KRAKOW
GIBSON, DUNN & CRUTCHER LLP
DALLAS, TX

OSCAR GARZA
GIBSON, DUNN & CRUTCHER LLP
ORANGE COUNTY, CA

THEODORE J. BOUTROUS, JR.
Counsel of Record
THOMAS H. DUPREE
GIBSON, DUNN & CRUTCHER LLP
1050 Connecticut Avenue, N.W.
Washington, D.C. 20036
(202) 955-8500
Counsel for Petitioner

April 12, 1999.